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SUBJECT: ECUADOR ANNOUNCES BOND BUYBACK "A SUCCESS"

Reftel: Quito 277

¶1. (SBU) Summary: On June 11, Ecuador's Minister of Finance presented the results of the GOE's bond repurchase, which resulted in the repurchase of 91% of the country's 2010 and 2030 Global bonds at a 65-70% discount. Although President Correa called the repurchase a success, some critics questioned the use of Ecuador's scarce liquidity for the buyback. End Summary.

¶2. (U) On June 11, Finance Minister Elsa Viteri announced that the GOE successfully bought back $2.9 billion (91%) of the country's 2012 and 2030 Global bonds at a 65-70% discount. The buyback took place through a modified Dutch auction process, based on a proposal initially presented to bondholders on April 20 (reftel). (Note: Of Ecuador's three outstanding bond issuances (2012, 2015, and 2030), the 2012 and 2030 were restructurings of previous debt and declared illegitimate by the GOE.) Viteri remarked that the government had not used any internal or foreign debt resources to finance the operation, which she termed "legitimate, legal and transparent." She claimed the repurchase represented savings on debt service of $7.5 billion through the year 2030 or $30 million per month, which would be used instead to finance social programs, education, and production. President Correa echoed her remarks, commenting that his government had done what other governments had been afraid to do.

Market Manipulation?

¶3. (SBU) The repurchase of $2.9 billion worth of 2012 and 2030 bonds at a price of 35 cents on the dollar would represent a disbursement of about $1 billion. However, according to official figures, government reserves showed a drop of only $243 million between May 22 and May 29, the time the bond repurchase went through. This amount is much less than would be needed to repurchase the bonds, and lends credence to the widely held belief that the GOE repurchased some of the bonds previously in December 2008, following its report that the debt was illegitimate. An earlier purchase could have given the GOE an advantage by possibly reducing the number of remaining bondholders and their influence. Contacts from the Central Bank confirmed privately that the amount disbursed for the bond repurchase on May 29 was only $305 million.

Effect on Public Finances

¶4. (SBU) Fiscal balances have fallen dramatically following the repurchase disbursement, as the GOE has not only used its available liquidity to finance the debt repurchase, but has maintained its projected pattern of current expenditures. Despite the recent increase in oil prices, of Ecuador's $2.5 billion in international reserves, only $300 million, about a month of nonfinancial public sector expenditures, belong to the Treasury. The rest belong to Social Security, other government entities, and private banks' legal reserves. Minister Viteri has made assurances that in the coming

months fiscal balances will improve due to expected loans totaling $ 1.5 billion from regional financial institutions including the IDB, the CAF and the FLAR. However, most of the expected loans are linked to projects so are not really liquid resources.

Outstanding Debt

¶5. (U) Approximately 19% of the 2012 and 7% of the 2030 bonds remain in the market, for a total of about $289 million. On June 17, Minister Viteri reported that the GOE had initiated contact with Italian entities who the GOE believes hold the majority of the outstanding bonds. Viteri announced that bondholders who had been unable to participate in the buyback for regulatory reasons would still be able to sell their bonds for the 35-cent price, but that for others, the price would be lower than 35 cents.

¶6. (SBU) As a result of the repurchase, overall Ecuadorian foreign debt has fallen by 29%, to about $ 7.1 billion. Outstanding debt includes, in addition to $ 1.2 billion in commercial debt, $ 4.3 billion in multilateral debt (including debt from the CAF, IDB, and World Bank), and $ 1.4 billion in bilateral debt from different countries such as Brazil and Spain. In an interview on June 12, President Correa stated that Ecuador would be reviewing the legitimacy of multilateral loans and loans from other governments in the coming months. He claimed that loans from entities such as the World Bank involved "criminal acts by previous governments." However, Minister Viteri then announced that Ecuador would continue to try to reduce its debt load through dialogue, as part of its desire for "a positive and balanced relationship with the international financial community," apparently trying to moderate what the President had said.

¶7. (SBU) Comment: The GOE seems to have succeeded in its debt repurchase, although analysts believe fiscal cash flow management will be a problem in 2010. Market manipulation may still be an issue, although with most bondholders having already cashed in, there does not appear to be many left to call for charges. The big question will be whether the default will have a significant impact on access to credit in the longer term. End Comment.

HODGES